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December 8, 2015

Mr. Chris Bonvenuto
Santa Monica Community
College District
1900 Pico Blvd.
Santa Monica, CA 90405-1628

Ms. Jill Kanemasu
State Controller's Office
Accounting and Reporting
3301 C Street, Suite 700
Sacramento, CA 95816

And Parties, Interested Parties, and Interested Persons (See Mailing List)

Re: **Decision**

Health Fee Elimination, 08-4206-I-17

Former Education Code Section 72246 (Renumbered as 76355);

Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1);

Statutes 1987, Chapter 1118 (AB 2336)


Fiscal Years: 2003-2004, 2004-2005, and 2005-2006

Santa Monica Community College District, Claimant

Dear Mr. Bonvenuto and Ms. Kanemasu:

On December 3, 2015, the Commission on State Mandates adopted the decision on the above-entitled matter.

Sincerely,

 for

Heather Halsey
Executive Director

BEFORE THE
COMMISSION ON STATE MANDATES
STATE OF CALIFORNIA

IN RE INCORRECT REDUCTION CLAIM
ON:

Former Education Code Section 72246
(Renumbered as § 76355)¹

Statutes 1984, Chapter 1 (1983-1984 2nd Ex.
Sess.) (AB2X 1); Statutes 1987, Chapter 1118
(AB 2336)

Fiscal Years 2003-2004, 2004-2005, and
2005-2006

Santa Monica Community College District,
Claimant

Case No.: 08-4206-I-17

Health Fee Elimination

DECISION PURSUANT TO
GOVERNMENT CODE SECTION 17500 ET
SEQ.; CALIFORNIA CODE OF
REGULATIONS, TITLE 2, DIVISION 2,
CHAPTER 2.5. ARTICLE 7

(Adopted December 3, 2015)

(Served December 8, 2015)

DECISION

The Commission on State Mandates (Commission) heard and decided this incorrect reduction claim (IRC) during a regularly scheduled hearing on December 3, 2015.

The law applicable to the Commission's determination of a reimbursable state-mandated program is article XIII B, section 6 of the California Constitution, Government Code section 17500 et seq., and related case law.

The Commission adopted the proposed decision to deny this IRC on consent, with Commission members Chivaro, Hariri, Morgan, and Ortega voting to adopt the consent calendar. Commission members Olsen, Ramirez, and Saylor were not present at the hearing.

Summary of the Findings

This analysis addresses reductions made by the State Controller's Office (Controller) to reimbursement claims of the Santa Monica Community College District (claimant) for fiscal years 2003-2004, 2004-2005, and 2005-2006 under the *Health Fee Elimination* program. Over the three fiscal years in question, the Controller reduced costs totaling \$795,942. The Controller found that claimant incorrectly calculated indirect cost rates for the three fiscal years and understated offsetting fees.

Pursuant to Government Code section 17551(d), the Commission concludes that the following reductions are correct as a matter of law and are not arbitrary, capricious, or entirely lacking in evidentiary support:

- The reduction in indirect costs claimed for all three fiscal years is correct because claimant used the OMB Circular A-21 methodology, but did not obtain federal approval

¹ Statutes 1993, chapter 8.

for its cost rate proposals in accordance with the OMB Circular. The Controller recalculated indirect costs by using the FAM-29C methodology.

- The reduction in costs claimed due to claimant’s reporting of offsetting revenue collected, rather than the amount authorized to be charged, is correct as a matter of law and in accordance with *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, and is not arbitrary, capricious, or entirely lacking in evidentiary support.

Accordingly, the Commission denies this IRC.

I. Chronology

- 01/04/2006 Claimant signed its fiscal year 2003-2004 and 2004-2005 reimbursement claims.²
- 01/09/2007 Claimant signed its fiscal year 2005-2006 reimbursement claim.³
- 11/14/2008 The Controller issued its final audit report.⁴
- 02/03/2009 Claimant filed this IRC.⁵
- 10/07/2014 The Controller filed late comments on the IRC.⁶
- 08/11/2015 The Commission issued the draft proposed decision.⁷
- 10/28/2015 The Controller filed late comments, supporting the draft proposed decision.⁸

II. Background

Health Fee Elimination Program

Prior to 1984, former Education Code section 72246 authorized community college districts that voluntarily provided health supervision and services, direct and indirect medical and hospitalization services, or operation of student health centers to charge almost all students a health service fee not to exceed \$7.50 for each semester or \$5 for each quarter or summer

² Exhibit A, Incorrect Reduction Claim, pages 69, 118.

³ Exhibit A, Incorrect Reduction Claim, page 178.

⁴ Exhibit A, Incorrect Reduction Claim, Audit, page 56.

⁵ Exhibit A, Incorrect Reduction Claim.

⁶ Exhibit B, Controller’s Late Comments on the IRC filed October 7, 2014. Note that pursuant to Government Code section 17553(d) “the Controller shall have no more than 90 days after the claim is delivered or mailed to file any rebuttal to an incorrect reduction claim. The failure of the Controller to file a rebuttal to an incorrect reduction claim shall not serve to delay the consideration of the claim by the Commission.” However, in this instance, due to the backlog of IRCs, these late comments have not delayed consideration of this item and so have been included in the analysis and proposed decision.

⁷ Exhibit C, Draft Proposed Decision.

⁸ Exhibit D, Controller’s Comments on Draft Proposed Decision.

session, to fund these services.⁹ In 1984, the Legislature repealed the community colleges' fee authority for health services.¹⁰ However, Legislature also reenacted section 72246, to become operative on January 1, 1988, to reauthorize the fee at \$7.50 for each semester (or \$5 per quarter or summer session).¹¹

In addition to temporarily repealing community college districts' fee authority, Statutes 1984, chapter 1 required any district which provided health services during the 1983-1984 fiscal year, for which districts were previously authorized to charge a fee, to maintain the health services at the level provided during the 1983-1984 fiscal year for every subsequent fiscal year until January 1, 1988.¹² As a result, community college districts were required to maintain health services provided in the 1983-1984 fiscal year without any fee authority for this purpose until January 1, 1988.

In 1987,¹³ the Legislature amended former Education Code section 72246, operative January 1, 1988, to incorporate and extend the maintenance of effort provisions of former Education Code section 72246.5, which became inoperative by its own terms as of January 1, 1988.¹⁴ In addition, Statutes 1987, chapter 1118 restated that the fee would be reestablished at not more than \$7.50 for each semester, or \$5 for each quarter or summer session.¹⁵ As a result, beginning January 1, 1988 all community college districts were required to maintain the same level of health services they provided in the 1986-1987 fiscal year each year thereafter, with a limited fee authority to offset the costs of those services.¹⁶ In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar.¹⁷

⁹ Former Education Code section 72246 (Stats. 1981, ch. 763) [Low-income students, students that depend upon prayer for healing, and students attending a college under an approved apprenticeship training program, were exempt from the fee.].

¹⁰ Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4 [repealing Education Code section 72246].

¹¹ Statutes 1984, 2nd Extraordinary Session 1984, chapter 1, section 4.5.

¹² Education Code section 72246.5 (Stats. 1984, 2d. Ex. Sess., ch. 1, § 4.7).

¹³ Statutes 1987, chapter 1118.

¹⁴ Education Code section 72246 (as amended, Stats. 1987, ch. 1118). See also former Education Code section 72246.5 (Stats. 1984, 2d Ex. Sess., ch. 1, § 4.7).

¹⁵ Education Code section 72246 (as amended, Stats. 1987, ch. 1118).

¹⁶ In 1992, section 72246 was amended to provide that the health fee could be increased by the same percentage as the Implicit Price Deflator whenever that calculation would produce an increase of one dollar. (Education Code section 72246 (as amended, Stats. 1992, ch. 753). In 1993, former Education Code section 72246, was renumbered as Education Code section 76355. (Stats. 1993, ch. 8).

¹⁷ Education Code section 72246 (as amended, Stats. 1992, ch. 753). In 1993, former Education Code section 72246, was renumbered as Education Code section 76355. (Stats. 1993, ch. 8).

On November 20, 1986, the Commission determined that Statutes 1984, chapter 1 imposed a reimbursable state-mandated new program upon community college districts. On August 27, 1987, the Commission adopted parameters and guidelines for the *Health Fee Elimination* program. On May 25, 1989, the Commission adopted amendments to the parameters and guidelines to reflect amendments made by Statutes 1987, chapter 1118.

The parameters and guidelines generally provide that eligible community college districts shall be reimbursed for the costs of providing a health services program, and that only services specified in the parameters and guidelines and provided by the community college district in the 1986-1987 fiscal year may be claimed.

Controller's Audit and Summary of the Issues

Claimant submitted reimbursement claims for the three fiscal years at issue, claiming costs totaling \$1,104,368 (less an \$11,000 penalty for late filing). Following a field audit, the Controller reduced the costs claimed by \$795,942, based on the following audit findings:

- Reduction of \$153,507 based on overstated indirect costs claimed for fiscal years 2003-2004, 2004-2005, and 2005-2006. Claimant calculated the indirect cost rates in accordance with OMB Circular A-21, but did not obtain federal approval for its use of the OMB Circular A-21 methodology.¹⁸
- Understated offsetting health fee authority for all three fiscal years totaling \$761,656, based upon claimant reporting only health service fee revenue collected, rather than health service fees authorized to be collected. The Controller recalculated offsetting fee authority by using student enrollment and Board of Governor's Grant (BOGG) recipient data reported by claimant to the California Community Colleges Chancellor's Office and the authorized health service fee rates identified by the Chancellor.¹⁹

Claimant disputes the reductions.

III. Positions of the Parties

Santa Monica Community College District's Position

Claimant asserts that the Controller's reduction of \$153,507 in overstated indirect costs on the basis that "the district did not obtain federal approval for its [indirect cost rates,]" was incorrect. Claimant argues that the claiming instructions are "merely a statement of the ministerial preferences of the Controller and have no force of law..."²⁰ Claimant also asserts that there is no requirement in law that claimant's indirect cost rate must be 'federally' approved,²¹ and the Controller did not make findings that claimant's rate was excessive.²² Claimant also asserts that the reduction totaling \$761,656 for all fiscal years, based on understated authorized health service fees was incorrect, because the parameters and guidelines require claimants to state

¹⁸ Exhibit A, IRC, page 52.

¹⁹ Exhibit A, IRC, page 55.

²⁰ Exhibit A, Incorrect Reduction Claim, pages 8-9.

²¹ Exhibit A, Incorrect Reduction Claim, pages 8-9.

²² Exhibit A, Incorrect Reduction Claim, page 12.

offsetting savings “experienced,” and claimant did not experience offsetting savings for fees that it did not charge to students.²³

Controller’s Position

The Controller asserts that claimant overstated its indirect costs for all three fiscal years because claimant used the federal OMB Circular A-21 but did not obtain federal approval for its indirect cost rate proposals, as required by the Controller’s claiming instructions and by OMB Circular A-21. The Controller asserts that its recalculation of claimant’s indirect cost rate using the state Form FAM-29C was reasonable.

The Controller further found that claimant understated its authorized health service fees for the audit period by \$761,656. The Controller asserts that claimant did not report any authorized health service fees, only those health service fees actually collected. Using enrollment and BOGG exemption data, the Controller calculated the health fees that claimant was authorized to collect, and reduced the claim by the amount not previously stated as offsetting revenues.²⁴ The Controller argues that, “to the extent community college districts can charge a fee, they are not required to incur a cost.”²⁵

IV. Discussion

Government Code section 17561(b) authorizes the Controller to audit the claims filed by local agencies and school districts and to reduce any claim for reimbursement of state mandated costs that the Controller determines is excessive or unreasonable.

Government Code Section 17551(d) requires the Commission to hear and decide a claim that the Controller has incorrectly reduced payments to the local agency or school district. If the Commission determines that a reimbursement claim has been incorrectly reduced, section 1185.9 of the Commission’s regulations requires the Commission to send the decision to the Controller and request that the costs in the claim be reinstated.

The Commission must review questions of law, including interpretation of the parameters and guidelines, de novo, without consideration of legal conclusions made by the Controller in the context of an audit. The Commission is vested with exclusive authority to adjudicate disputes over the existence of state-mandated programs within the meaning of article XIII B, section 6.²⁶ The Commission must also interpret the Government Code and implementing regulations in accordance with the broader constitutional and statutory scheme. In making its decisions, the Commission must strictly construe article XIII B, section 6 and not apply it as an “equitable remedy to cure the perceived unfairness resulting from political decisions on funding priorities.”²⁷

²³ Exhibit A, Incorrect Reduction Claim, page 17.

²⁴ Exhibit A, Incorrect Reduction Claim, Audit, page 55.

²⁵ Exhibit A, Incorrect Reduction Claim, page 55; Exhibit B, Controller’s Comments, page 23.

²⁶ *Kinlaw v. State of California* (1991) 54 Cal.3d 326, 331-334; Government Code sections 17551, 17552.

²⁷ *County of Sonoma, supra*, 84 Cal.App.4th 1264, 1280, citing *City of San Jose v. State of California* (1996) 45 Cal.App.4th 1802, 1817.

With regard to the Controller's audit decisions, the Commission must determine whether they were arbitrary, capricious, or entirely lacking in evidentiary support. This standard is similar to the standard used by the courts when reviewing an alleged abuse of discretion of a state agency.²⁸ Under this standard, the courts have found that:

When reviewing the exercise of discretion, “[t]he scope of review is limited, out of deference to the agency’s authority and presumed expertise: ‘The court may not reweigh the evidence or substitute its judgment for that of the agency. [Citation.]’” ... “In general ... the inquiry is limited to whether the decision was arbitrary, capricious, or entirely lacking in evidentiary support. . . .” [Citations.] When making that inquiry, the “ ‘ ‘court must ensure that an agency has adequately considered all relevant factors, and has demonstrated a rational connection between those factors, the choice made, and the purposes of the enabling statute.’ ”²⁹

The Commission must review also the Controller's audit in light of the fact that the initial burden of providing evidence for a claim of reimbursement lies with the claimant.³⁰ In addition, sections 1185.1(f)(3) and 1185.2(c) of the Commission's regulations require that any assertions of fact by the parties to an IRC must be supported by documentary evidence. The Commission's ultimate findings of fact must be supported by substantial evidence in the record.³¹

A. Claimant Did Not Comply with the OMB Circular A-21 in Preparing Its Indirect Cost Rate and, Thus, the Controller's Reduction of These Costs Is Correct as a Matter of Law and the Recalculation of Indirect Costs Using the FAM-29C Is Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced indirect costs claimed by a total of \$153,507 for all three fiscal years based on alleged errors in the calculation and application of the indirect cost rate. Claimant used the OMB Circular A-21 to calculate its indirect cost rates at 34.07 percent, 36.91 percent, and 34.25 percent during the audit period, but failed to obtain federal approval of the rates used as required by the claiming instructions and the OMB Circular A-21. The Controller recalculated indirect costs for all three fiscal years using the state Form FAM-29C allowed in the claiming instructions, which resulted in rates of 19.14 percent, 32.11 percent, and 33.43 percent.³²

Claimant disputes the Controller's findings that the indirect cost rate proposal was incorrectly applied, charging that the Controller's conclusions were without basis in the law.

²⁸ *Johnston v. Sonoma County Agricultural* (2002) 100 Cal.App.4th 973, 983-984. See also *American Bd. of Cosmetic Surgery, Inc. v. Medical Bd. of California* (2008) 162 Cal.App.4th 534, 547.

²⁹ *American Bd. of Cosmetic Surgery, Inc, supra*, 162 Cal.App.4th 534, 547-548.

³⁰ *Gilbert v. City of Sunnyvale* (2005) 130 Cal.App.4th 1264, 1274-1275.

³¹ Government Code section 17559(b), which provides that a claimant or the state may commence a proceeding in accordance with the provisions of section 1094.5 of the Code of Civil Procedure to set aside a decision of the Commission on the ground that the Commission's decision is not supported by substantial evidence in the record.

³² Exhibit A, Incorrect Reduction Claim, page 66.

1. The parameters and guidelines expressly require claimants to claim indirect costs in the manner described in the Controller’s claiming instructions, which in turn provide for an indirect cost rate developed in accordance with federal OMB Circular A-21 guidelines or the state Form FAM-29C.

If the Commission approves a test claim and determines there are costs mandated by the state, parameters and guidelines are required to be adopted to determine the amount to be subvented.³³ Parameters and guidelines, in addition to identifying the reimbursable activities, provide instructions for eligible claimants to prepare reimbursement claims for the direct and indirect costs of a state-mandated program.³⁴ The Commission’s adoption of parameters and guidelines is quasi-judicial and, therefore, the parameters and guidelines are final and binding on the parties unless set aside by a court pursuant to Government Code section 17559.³⁵ Claimants are required as a matter of law to file reimbursement claims in accordance with the parameters and guidelines.³⁶ Moreover, the parameters and guidelines cannot be amended by the Commission absent the filing of a request to amend the parameters and guidelines by a local government or state agency pursuant to Government Code section 17557. In this case, the parameters and guidelines for the *Health Fee Elimination* program have not been challenged, and no party has requested they be amended. The parameters and guidelines are therefore binding and must be applied to the reimbursement claims here.

Section VI. of the parameters and guidelines provide that “*indirect costs may be claimed in the manner described by the State Controller in his claiming instructions.*”³⁷ Claimant argues that the word “may” in the indirect cost language of the parameters and guidelines is permissive, and that therefore the parameters and guidelines do not require that indirect costs be claimed in the manner described by the Controller.³⁸

Claimant’s argument is unsound: the parameters and guidelines plainly state that “indirect costs may be claimed in the manner described by the State Controller in his claiming instructions.” The interpretation that is consistent with the plain language of the parameters and guidelines is that “indirect costs may be claimed,” or may not, but if a claimant chooses to claim indirect costs, the claimant must adhere to the parameters and guidelines and claim indirect costs in the manner described in the Controller’s claiming instructions.

³³ Government Code section 17557.

³⁴ Government Code section 17557; California Code of Regulations, title 2, section 1183.7.

³⁵ *California School Boards Assoc. v. State of California* (2009) 171 Cal.App.4th 1183, 1200, which stated the following: “[U]nless a party to a quasi-judicial proceeding challenges the agency’s adverse findings made in that proceeding, by means of a mandate action in superior court, those findings are binding in later civil actions.” [Citation omitted.]

³⁶ Government Code sections 17561(d)(1); 17564(b); and 17571. See also, *Clovis Unified School Dist. v. Chiang* (2010) 188 Cal.App.4th 794, 799, finding that the parameters and guidelines are regulatory.

³⁷ Exhibit A, Incorrect Reduction Claim, page 28.

³⁸ Exhibit A, Incorrect Reduction Claim, page 11.

The claiming instructions specific to the *Health Fee Elimination* mandate, are found in the School Mandated Cost Manual which is revised each year and contains claiming instructions applicable to all school and community college mandated programs. The cost manual issued by the Controller's Office in September 2004 governs the reimbursement claim filed for the fiscal year 2003-2004.³⁹ This cost manual provides two options for claiming indirect costs by either using the OMB Circular A-21, or the FAM-29C:

A college has the option of using a federally approved rate, utilizing the cost accounting principles from *Office of Management and Budget Circular A-21* "Cost Principles for Educational Institutions," or the Controller's methodology outlined in the following paragraphs. If the federal rate is used, it must be from the same fiscal year in which the costs were incurred.

The Controller allows the following methodology for use by community colleges in computing an indirect cost rate for state mandates. The objective of this computation is to determine an equitable rate for use in allocating administrative support to personnel that performed the mandated cost activities claimed by the community college. This methodology assumes that administrative services are provided to all activities of the institution in relation to the direct costs incurred in the performance of those activities. *Form FAM-29C* has been developed to assist the community college in computing an indirect cost rate for state mandates. . . .

[¶]

The [FAM-29C] computation is based on total expenditures as reported in "California Community Colleges Annual Financial and Budget Report, Expenditures by Activity (CCFS-311)." Expenditures classified by activity are segregated by the function they serve. Each function may include expenses for salaries, fringe benefits, supplies, and capital outlay. OMB Circular A-21 requires expenditures for capital outlays to be excluded from the indirect cost rate computation.

Generally, a direct cost is one incurred specifically for one activity, while indirect costs are of a more general nature and are incurred for the benefit of several activities. As previously noted, the objective of this computation is to equitably allocate administrative support costs to personnel that perform mandated cost activities claimed by the college. For the purpose of this computation we have defined indirect costs to be those costs which provide administrative support to personnel who perform mandated cost activities. We have defined direct costs to be those indirect costs that do not provide administrative support to personnel who perform mandated costs activities and those costs that are directly related to instructional activities of the college. Accounts that should be classified as indirect costs are: Planning and Policy Making, Fiscal Operations, General Administrative Services, and Logistical Services. If any costs included in these accounts are claimed as a mandated cost, i.e., salaries of employee performing mandated cost activities, the cost should be reclassified as a direct cost. Accounts in the following groups of accounts should be classified as direct costs:

³⁹ Exhibit E, School Mandated Cost Manual excerpts.

Instruction, Instructional Administration, Instructional Support Services, Admissions and Records, Counseling and Guidance, Other Student Services, Operation and Maintenance of Plant, Community Relations, Staff Services, Non-instructional Staff-Retirees' Benefits and Retirement Incentives, Community Services, Ancillary Services and Auxiliary Operations. A college may classify a portion of the expenses reported in the account Operation and Maintenance of Plant as indirect. The claimant has the option of using a 7% or a higher expense percentage is allowable if the college can support its allocation basis.

The rate, derived by determining the ratio of total indirect expenses and total direct expenses when applied to the direct costs claimed, will result in an equitable distribution of the college's mandate related indirect costs. . . .⁴⁰

The claiming instructions for fiscal years 2004-2005 and 2005-2006 did not authorize the use of the federal OMB Circular A-21 methodology, but only authorize the use of the FAM-29C, unless the parameters and guidelines for the program specifically allows the use of federal OMB rate or the 7 percent default rate as follows:

A CCD may claim indirect costs using the Controller's methodology (FAM-29C), outlined in the following paragraphs. If specifically allowed by a mandated program's Ps & Gs, a district may alternately choose to claim indirect costs using either (1) a federally approved rate prepared in accordance with Office of Management and Budget (OMB) Circular A-21, *Cost Principles for Educational Institutions*; or (2) a flat 7% rate.⁴¹

In this case, the parameters and guidelines do not specifically authorize the use of the OMB Circular method or the seven percent default rate, but state that indirect costs may be claimed "in the manner described by the State Controller in his claiming instructions."

Claimants who choose the OMB Circular A-21 methodology must obtain federal approval of the calculation for the proposed rate by the "cognizant federal agency" through formal negotiation, an informal correspondence process, or a simplified method which sets the indirect cost rate using a salaries and wage base.⁴² The "cognizant federal agency," is normally either the Federal Department of Health and Human Services or the Department of Defense's Office of Naval Research.⁴³ The end result of the negotiation process is a sponsored agreement in which final approval lies with the federal government negotiating the rate and must be supported by "adequate documentation to support costs charged to sponsored agreements."⁴⁴

Claimant used the methodology in the OMB Circular A-21, and asserts that the Controller's requirement of a specific formula (the FAM-29C) to calculate indirect costs has not been adopted

⁴⁰ Exhibit E, School Mandated Cost Manual, issued September 2004, pages 12 and 17.

⁴¹ *Id.*

⁴² Exhibit F, OMB Circular A-21, section G(11), pages 37-39.

⁴³ *Id.*

⁴⁴ Exhibit F, OMB Circular A-21, page 6.

as a regulation under the Administrative Procedure Act (APA) and, thus, the claiming instructions create an underground regulation.⁴⁵

The Commission has previously declined to determine whether the claiming instructions constitute a violation of the APA, creating an “underground” regulation, despite the invitation to do so by claimants in a number of prior IRCs.⁴⁶ Those decisions were instead decided on alternative grounds.

Similarly, in this case, the Commission does not need to reach the alleged underground regulation issue for the use of the FAM-29C because, as described below, the claimant failed to obtain federal approval for its use of the OMB Circular A-21 methodology as required by the OMB Circular A-21 itself.

2. Claimant failed to obtain federal approval for its indirect cost rate as required by OMB Circular A-21 and, thus, the reduction is correct as a matter of law.

If a claimant chooses to use the OMB Circular A-21 methodology, claimant must obtain federal approval for the rate calculated. The OMB Circular A-21 is specific in defining the method for developing an indirect cost rate, but does not specifically identify those costs that can be claimed as direct costs. OMB Circular A-21 provides:

General. Direct costs are those costs that can be identified specifically within a sponsored project, an instructional activity, or any other instructional activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy.⁴⁷

Claimants who choose the OMB Circular A-21 methodology must obtain federal approval of their calculation of their rates through formal negotiation, an informal correspondence process or a simplified method which sets the indirect cost rate using a salaries and wage base.⁴⁸ The end result of the negotiation process is a sponsored agreement in which final approval lies with the federal government negotiating the rate and must be supported by “adequate documentation to support costs charged to sponsored agreements.”⁴⁹ The OMB Circular A-21 establishes principles for determining costs applicable to grants, contracts, and other agreements between the federal government and educational institutions. Section G(11) of the OMB Circular A-21 governs the determination of indirect cost rates and requires the federal approval of a proposed rate by the “cognizant federal agency,” which is normally either the Federal Department of Health and Human Services or the Department of Defense’s Office of Naval Research.⁵⁰ Thus, a claimant that has received federal approval for their indirect cost rate has negotiated specific direct costs with the relevant federal approving agency.

⁴⁵ Exhibit A, IRC, page 10.

⁴⁶ See e.g., Adopted Decision in *Graduation Requirements* IRC 01-4435-I-41, page 4.

⁴⁷ Exhibit E, OMB Circular A-21, page 19.

⁴⁸ Exhibit E, OMB Circular A-21, pages 37-39.

⁴⁹ Exhibit E, OMB Circular A-21, page 6.

⁵⁰ Exhibit E, OMB Circular A-21.

Here, claimant did not negotiate a particular rate but applied the general principles of the OMB Circular A-21 to direct costs it determined to be applicable. As claimant did not negotiate with a federal agency to determine appropriate direct costs used to calculate the indirect costs rate, there has been no federal analysis of whether the direct costs used would have received federal approval. Thus, the Controller, in auditing the indirect cost rate used by claimant could not determine whether claimant's direct costs used to calculate their indirect cost rate would have received federal approval or been rejected as including impermissible direct costs.⁵¹ Thus, the reduction of costs is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

3. The Controller's recalculation of indirect costs is not arbitrary, capricious, or entirely lacking in evidentiary support.

Here, instead of reducing indirect costs to \$0, the Controller recalculated claimant's indirect cost rate by using its own Form FAM-29C, a method of calculating indirect costs that the Controller has included in its claiming instructions for many years, and which has been incorporated into parameters and guidelines for several state-mandated programs.⁵² The claiming instructions provide:

FAM-29C uses total expenditures that districts report in their *California Community Colleges Annual Financial and Budget Report (CCFS-311)*, Expenditures by Activity for the General Fund – Combined. The computation excludes Capital Outlay and Other Outgo in accordance with OMB Circular A-21. The indirect cost rate computation includes any depreciation or use allowance applicable to district buildings and equipment. Districts calculate depreciation or use allowance costs separately from the CCFS-311 report and should calculate them in accordance with OMB Circular A-21.⁵³

The cost manual also states that, "FAM-29C strives to equitably allocate administrative support costs to personnel that perform mandated activities claimed by the CCD." Thus, the calculation of indirect costs under Form FAM-29C are similar to the calculation under OMB Circular A-21, but not identical. For example, OMB Circular A-21 allows direct costs for library costs and department administration expenses, but Form FAM-29C excludes those costs.⁵⁴

The Controller could not recalculate using the OMB Circular A-21 methodology as the Controller had no way to determine which direct costs the federal approving agency would include in the negotiated base rate. As previously stated, the standard of review

⁵¹ Exhibit E. OMB Circular A-133 compliance supplement 2014, part 3, beginning at page 3-B-36, which addresses allowable and unallowable costs under OMB Circular A-21.

⁵² See Exhibit B , SCO Comments, Claiming Instructions Excerpts from (September 2004, December 2005) and *Enrollment Fee & Waivers Parameters and Guidelines*, adopted on January 26, 2006; *Agency Fee Arrangements Parameters and Guidelines*, adopted on July 28, 2006; and *Integrated Waste Management Parameters and Guidelines*, adopted on September 26, 2008.

⁵³ Exhibit E, Excerpts from Community Colleges Mandated Cost Manual 12/05, page 10.

⁵⁴ Exhibit E, Excerpts from Community Colleges Mandated Cost Manual 12/05, page 10.

which the Commission employs to review the Controller's audit provides that the Commission may "not reweigh the evidence or substitute its judgment for that of the agency."⁵⁵ Thus, the Commission cannot compel the Controller to use other auditing procedures in place of the Form FAM-29C. Therefore, the Controller's use of the Form FAM-29C was not arbitrary, capricious, or totally lacking in evidentiary support.

Accordingly, the Commission finds the reduction of indirect costs for fiscal years 2003-2004, 2004-2005, and 2005-2006 is not arbitrary or capricious or entirely lacking in evidentiary support.

B. The Controller's Reduction for Understated Offsetting Fee Authority Is Correct as a Matter of Law, and Not Arbitrary, Capricious, or Entirely Lacking in Evidentiary Support.

The Controller reduced costs for the three fiscal years by a total of \$761,656 because claimant understated its offsetting health service fee authority. In each fiscal year, claimant reported only those health service fees collected, and not the full amount of the fees authorized to be charged. Using enrollment and BOGG exemption data, the Controller calculated the health fees that claimant was authorized to collect, which resulted in a reduction of costs claimed.

The Commission finds that the correct calculation and application of offsetting revenue from student health fees has been resolved by the *Clovis Unified* decision, and that the reduction is correct as a matter of law.

After claimant filed its IRC, the Third District Court of Appeal issued its opinion in *Clovis Unified*, which specifically addressed the Controller's practice of reducing claims of community college districts by the maximum fee amount that districts are statutorily authorized to charge students, whether or not a district chooses to charge its students those fees. As cited by the court, the Controller's Health Fee Rule states in pertinent part:

Eligible claimants will be reimbursed for health service costs at the level of service provided in the 1986/87 fiscal year. The reimbursement will be reduced by the amount of student health fees authorized per the Education Code [section] 76355.⁵⁶

The Health Fee Rule relies on Education Code section 76355(a), which provides in relevant part:

(a)(1) The governing board of a district maintaining a community college may require community college students to pay a fee in the total amount of not more than ten dollars (\$10) for each semester, seven dollars (\$7) for summer school, seven dollars (\$7) for each intersession of at least four weeks, or seven dollars (\$7) for each quarter for health supervision and services, including direct or indirect medical and hospitalization services, or the operation of a student health center or centers, or both.

(a)(2) The governing board of each community college district may increase [the health service fee] by the same percentage increase as the Implicit Price Deflator for State and Local Government Purchase of Goods and Services. Whenever that

⁵⁵ *American Bd. of Cosmetic Surgery, Inc, supra*, 162 Cal.App.4th 534, 547-548.

⁵⁶ *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794, 811.

calculation produces an increase of one dollar (\$1) above the existing fee, the fee may be increased by one dollar (\$1).

Pursuant to the plain language of Education Code section 76355(a)(2), the fee authority given to districts automatically increases at the same rate as the Implicit Price Deflator; when that calculation produces an increase of one dollar above the existing fee, the fee may be increased by one dollar.⁵⁷ The Chancellor of the California Community Colleges issues a notice to the governing boards of all community colleges when a fee increase is triggered.⁵⁸ Here, the Controller asserts that claimant had the authority to increase its fee in accordance with the notices periodically issued by the Chancellor of the California Community Colleges. The Controller argues that the claimant was required to claim offsetting fees in the amount authorized. Claimant argues that the actual increase of the fee imposed upon students requires action of the community college district governing board, and that “the Controller cannot rely on the Chancellor’s notice as a basis to adjust the claim for ‘collectible’ student health services fees,”⁵⁹ because the fees levied on students are raised by action of the governing board of the community college district. But the *authority* to impose the health service fees increases with the Implicit Price Deflator, as noticed by the Chancellor, and without any legislative action by a community college district, or any other entity (state or local). Moreover, the court in *Clovis Unified* upheld the Controller’s use of the Health Fee Rule to reduce reimbursement claims based on the fees districts are *authorized* to charge. In making its decision the court notes that the concept underlying the state mandates process that Government Code sections 17514 and 17556(d) embody is:

To the extent a local agency or school district “has the authority” to charge for the mandated program or increased level of service, that charge cannot be recovered as a state-mandated cost.⁶⁰

The court also notes that, “this basic principle flows from common sense as well. As the Controller succinctly puts it, ‘Claimants can choose not to require these fees, but not at the state’s expense.’”⁶¹ Additionally, in responding to the community college districts’ argument that, “since the Health Fee Rule is a claiming instruction, its validity must be determined *solely* through the Commission’s P&G’s,”⁶² the court held:

⁵⁷ See Education Code section 76355 (Stats. 1995, ch. 758 (AB 446)). The Implicit Price Deflator for State and Local Purchase of Goods and Services is a number computed annually (and quarterly) by the United States Department of Commerce as part of its statistical series on measuring national income and product, and is used to adjust government expenditure data for the effect of inflation.

⁵⁸ See, e.g., Exhibit A, Incorrect Reduction Claim [Letter from Chancellor, page 66].

⁵⁹ Exhibit A, Incorrect Reduction Claim, page 14.

⁶⁰ *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794, 812.

⁶¹ *Ibid.*

⁶² *Ibid.* (Original italics.)

To accept this argument, though, we would have to ignore, and so would the Controller, the fundamental legal principles underlying state-mandated costs. We conclude *the Health Fee Rule is valid*.⁶³ (Italics added.)

Thus, pursuant to the court's decision in *Clovis Unified*, the Health Fee Rule used by the Controller to adjust reimbursement claims filed by claimants for the *Health Fee Elimination* program is valid. Since the *Clovis* case is a final decision of the court addressing the merits of the issue presented here, the Commission, under principles of stare decisis, is required to apply the rule set forth by the court.⁶⁴ In addition, the *Clovis* decision is binding on the claimant under principles of collateral estoppel.⁶⁵ Collateral estoppel applies when (1) the issue necessarily decided in the previous proceeding is identical to the one that is currently being decided; (2) the previous proceeding terminated with a final judgment on the merits; (3) the party against whom collateral estoppel is asserted is a party to or in privity with a party in the previous proceeding; and (4) the party against whom the earlier decision is asserted had a full and fair opportunity to litigate the issue.⁶⁶ Here, the claimant was a party to the *Clovis* action, and under principles of collateral estoppel, the court's decision is binding on the claimant with respect to these reimbursement claims.⁶⁷

The Commission further finds that the Controller's recalculation of authorized offsetting revenues, using student enrollment data that claimant reported to the California Community College Chancellor's Office and BOGG exemption data supported by claimant's records, was not arbitrary, capricious, or entirely lacking in evidentiary support. The documents are public records maintained by claimant in the normal course of business, and claimant has provided no other documents to support the offsetting health service fee revenue authorized for this program.

Accordingly, the Commission finds that the Controller's reduction for understated offsetting revenues is correct as a matter of law, and not arbitrary, capricious, or entirely lacking in evidentiary support.

⁶³ *Clovis Unified School Dist. v. Chiang, supra*, 188 Cal.App.4th 794, 812.

⁶⁴ *Fenske v. Board of Administration* (1980) 103 Cal.App.3d 590, 596.

⁶⁵ The petitioners in the *Clovis* case included Clovis Unified School District, El Camino Community College District, Fremont Unified School District, Newport-Mesa Unified School District, Norwalk-La Mirada Unified School District, Riverside Unified School District, San Mateo Community College District, Santa Monica Community College District, State Center Community College District, and Sweetwater Union High School District.

⁶⁶ *Roos v. Red* (2006) 130 Cal.App.4th 870, 879-880.

⁶⁷ *Roos, supra*, 130 Cal.App.4th 870, 879-880. Collateral estoppel applies when (1) the issue necessarily decided in the previous proceeding is identical to the one that is currently being decided; (2) the previous proceeding terminated with a final judgment on the merits; (3) the party against whom collateral estoppel is asserted is a party to or in privity with a party in the previous proceeding; and (4) the party against whom the earlier decision is asserted had a full and fair opportunity to litigate the issue.

V. Conclusion

Based on the foregoing, the Commission denies this IRC. Pursuant to Government Code section 17551(d), the Commission finds that the Controller's reduction of indirect costs and reduction of costs based on understated health service fees was correct as a matter of law and not arbitrary, capricious, or entirely lacking in evidentiary support.

COMMISSION ON STATE MANDATES

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RE: **Decision**

Health Fee Elimination, 08-4206-I-17

Former Education Code Section 72246 (Renumbered as 76355);

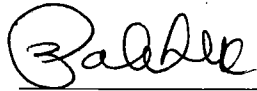
Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1);

Statutes 1987, Chapter 1118 (AB 2336)

Fiscal Years: 2003-2004, 2004-2005 and 2005-2006

Santa Monica Community College District, Claimant

On December 3, 2015, the foregoing decision of the Commission on State Mandates was adopted on the above-entitled matter.

 for

Heather Halsey, Executive Director

Dated: December 8, 2015

DECLARATION OF SERVICE BY EMAIL

I, the undersigned, declare as follows:

I am a resident of the County of Sacramento and I am over the age of 18 years, and not a party to the within action. My place of employment is 980 Ninth Street, Suite 300, Sacramento, California 95814.

On December 8, 2015, I served the:

Decision

Health Fee Elimination, 08-4206-I-17

Former Education Code Section 72246 (Renumbered as 76355);

Statutes 1984, Chapter 1 (1983-1984 2nd Ex. Sess.) (AB2X 1);

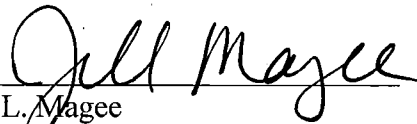
Statutes 1987, Chapter 1118 (AB 2336)

Fiscal Years: 2003-2004, 2004-2005, and 2005-2006

Santa Monica Community College District, Claimant

by making it available on the Commission's website and providing notice of how to locate it to the email addresses provided on the attached mailing list.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct, and that this declaration was executed on December 8, 2015 at Sacramento, California.



Jill L. Magee

Commission on State Mandates

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COMMISSION ON STATE MANDATES

Mailing List

Last Updated: 12/2/15

Claim Number: 08-4206-I-17

Matter: Health Fee Elimination

Claimant: Santa Monica Community College District

TO ALL PARTIES, INTERESTED PARTIES, AND INTERESTED PERSONS:

Each commission mailing list is continuously updated as requests are received to include or remove any party or person on the mailing list. A current mailing list is provided with commission correspondence, and a copy of the current mailing list is available upon request at any time. Except as provided otherwise by commission rule, when a party or interested party files any written material with the commission concerning a claim, it shall simultaneously serve a copy of the written material on the parties and interested parties to the claim identified on the mailing list provided by the commission. (Cal. Code Regs., tit. 2, § 1181.3.)

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